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APPLICATION OF SOUTHWESTERN	§	BEFORE THE
ELECTRIC POWER COMPANY FOR	§	PUBLIC UTILITY COMMISSION OF
AUTHORITY TO CHANGE RATES	§	TEXAS

CITIES ADVOCATING REASONABLE DEREGULATION'S

EXCEPTIONS TO THE PROPOSAL FOR DECISION

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October 7, 2021

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APPLICATION OF SOUTHWESTERN § BEFORE THE
ELECTRIC POWER COMPANY FOR § PUBLIC UTILITY COMMISSION OF
AUTHORITY TO CHANGE RATES § TEXAS

**CITIES ADVOCATING REASONABLE DEREGULATION'S
EXCEPTIONS TO THE PROPOSAL FOR DECISION**

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**CITIES ADVOCATING REASONABLE DEREGULATION'S
EXCEPTIONS TO THE PROPOSAL FOR DECISION**

The Cities Advocating Reasonable Deregulation¹ (“CARD”) hereby submit their *Exceptions to the Proposal for Decision* and in support thereof, show as follows:

I. Introduction/Summary [Preliminary Order (PO) Issues 1, 2, and 3]

CARD again extends its thanks and gratitude to the Administrative Law Judges (“ALJs”) for their attention to this case and their fairness in the conduct of the hearing. CARD has reviewed closely the ALJs’ Proposal for Decision (“PFD”) and though CARD continues to urge adoption of the adjustments to Southwestern Electric Power Company’s (“SWEPCO” or the “Company”) proposed revenue requirement set forth in summary fashion in CARD Exhibit No. 6, the direct testimony of Mr. Karl Nalepa, including the cost of capital proposed by Dr. J. Randall Woolridge’s direct testimony presented in CARD Exhibit No. 4, CARD limits its exceptions to a single issue: The ALJs’ conclusion regarding the appropriate return on equity (“ROE”) to employ in setting SWEPCO’s overall cost of capital, aka, its “rate of return” (“ROR”).²

The ALJs propose that the Commission adopt a ROE of 9.45%. For the reasons discussed below, CARD respectfully urges the Commission to adopt CARD’s witness, Dr. J. Randall Woolridge’s recommended ROE of 9.00%.

¹ The Cities Advocating Reasonable Deregulation is comprised of the Cities of Atlanta, Bloomberg, Carthage, Center, Daingerfield, Fruitvale, Gilmer, Gladewater, Hawkins, Henderson, Hooks, Jefferson, Kilgore, Lakeport, Longview, Marshall, Maud, Mineola, Mt. Enterprise, Mt. Pleasant, Mt. Vernon, Naples, New London, Omaha, Overton, Pittsburg, Queen City, Red Lick, Texarkana, Wake Village, Waskom, Wellington, White Oak, Winnsboro and Winona.

² CARD will retain the outline set forth in the parties’ briefs for sake of convenience but its exceptions are limited to the discussion in the PFD regarding return on equity.

- II. Invested Capital - Rate Base [PO Issues 4, 5, 10, 11, 12, 13, 14, 15, 16, 18, 19, 20, 21, 22]**
 - A. Generation, Transmission, and Distribution Capital Investment [PO Issues 4, 5, 10, 11, 13, 14, 15, 16]**
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 - 1. Self-Insurance Reserve [PO Issue 19 and 40]**
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- III. Rate of Return [PO Issues 4, 5, 8, 9]**
 - A. Overall Rate of Return, Return on Equity, Cost of Debt [PO Issue 8]**
 - 1. Return on Equity**
 - a. Overview**
 - b. Return on Equity**

In determining a reasonable return on equity for SWEPCO, CARD commends the ALJs for rejecting SWEPCO's witness, Mr. Dylan D'Ascendis's proposed "size" and "credit" adjustments;³ for rejecting the use of non-utilities as proxies for a utility, and in particular for

³ Proposal for Decision ("PFD") at 145.

SWEPCO;⁴ and for discounting use of Mr. D’Ascendis’s Predictive Risk Premium Model (“PRPM”).⁵ The ALJs correctly found that the credible evidence does not support Mr. D’Ascendis’s “size” and “credit” adjustments, his use of non-utilities as proxies for SWEPCO, and his Predictive Risk Premium Model as a credible “risk-premium model” for estimating SWEPCO’s cost of equity.⁶

CARD urged the ALJs to adopt a revenue requirement that employs an overall rate of return of 6.56% as recommended by Dr. J. Randall Woolridge.⁷ Dr. Woolridge’s proposed rate of return is based on his recommended cost of equity and SWEPCO’s cost of debt and capital structure shown in Table 1 below:

Table 1
CARD Rate of Return Recommendation

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate
Long-Term Debt	50.63%	4.18%	2.11%
Common Equity	<u>49.37%</u>	<u>9.00%</u>	<u>4.44%</u>
Total Capital	100.00%		6.56%

The ALJs concluded that a return on equity of 9.00% is within “a reasonable range for SWEPCO’s ROE,”⁸ but proposed a return on equity of 9.45%, the mid-point of their range for ROE.

For sake of convenience Table 2 below depicts the ALJs’ recommended rate of return and its components:

⁴ *Id.*

⁵ PFD at 146.

⁶ See CARD Exh. 4 – Direct Testimony and Exhibits of J. Randall Woolridge, Ph.D. at 61-63 for Dr. Woolridge’s critique of Mr. D’Ascendis’s PRPM approach to estimating SWEPCO’s cost of equity (hereinafter, “CARD Exh. 4 – Woolridge Dir. at __.”).

⁷ See CARD Post-Hearing Initial Brief at 13-40; and CARD Exh. 4 – Woolridge Dir. at 4.

⁸ The ALJs found a reasonable range for SWEPCO’s ROE to be from 9.00% to 9.90%. PFD at 146.

Table 2
ALJs' Rate of Return Recommendation

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate
Long-Term Debt	50.63%	4.18%	2.12%⁹
Common Equity	<u>49.37%</u>	<u>9.45%</u>	<u>4.68%</u>
Total Capital	100.00%		6.79%

CARD commends the ALJs for rejecting SWEPCO's proposed ROE of 10.35%, and for implicitly rejecting SWEPCO's proposed range of ROEs, which was truly an outlier ranging from a low of 10.32% to a high of 11.43%.¹⁰ However, CARD urges the Commission to adopt Dr. Woolridge's ROE of 9.00%, which is the lower end of the ALJs' range of ROEs.¹¹

The ALJs correctly observed that SWEPCO's witness, Mr. Dylan D'Ascendis's recommended ROE is the outlier noting that the Staff and intervenors' recommended ROEs were tightly grouped in a range of 9.0% to 9.225%, and Mr. D'Ascendis's recommended ROE ranged from 10.32% to 11.43%.¹²

Additionally, the ALJs' observation is correct that the ROE witnesses' findings based on their respective constant growth DCF analyses "produced relatively similar results—notably, with SWEPCO at 8.73% (direct) and 9.42% (rebuttal)—and the parties had few criticisms of each other's inputs and results."¹³ And, CARD agrees with the ALJs' conclusion that "it is appropriate to give the constant growth DCF analyses more weight, as Mr. D'Ascendis did himself."¹⁴

However, CARD disagrees with the statement that "parties had few criticisms of each other's inputs and results." Dr. Woolridge produced a study of the accuracy of analysts' EPS

⁹ CARD notes that while the tables show a difference between CARD's Weighted Cost Rate for debt (2.11%) and the ALJs' Weighted Cost Rate for debt (2.12%), the difference is a product of MS Excel's "rounding" parameters, and thus, there is no substantive difference between Dr. Woolridge's proposed Weighted Cost Rate for debt and the ALJs' corresponding factor.

¹⁰ The ALJs' range of ROEs is from 9.00% to 9.90%. See PFD at 146.

¹¹ *Id.*

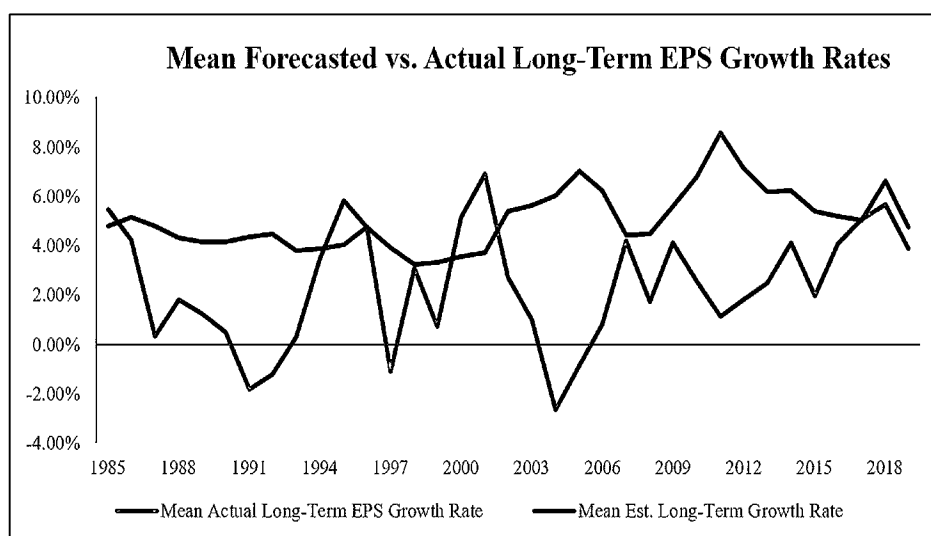
¹² PFD at 144-46.

¹³ *Id.*

¹⁴ PFD at 146.

growth rate forecasts for electric utilities over the past 35 years. The results are shown in Figure 1, below.

Figure 1¹⁵
Mean Forecasted vs. Actual Long-Term EPS Growth Rates
Electric Utilities
1985-2019



Data Source: S&P Global Market Intelligence, Capital IQ, I/B/E/S, 2021.

Figure 1 establishes that, with the exception of 1994-96 and 2000-2002, the mean *forecasted* EPS growth rate (depicted in the red line in Figure 1) is consistently greater than the achieved *actual* EPS growth rate over the time period. Over the entire period, the mean forecasted EPS growth rate is over 200 basis points above the actual EPS growth rate. Thus, a key area in which the parties indeed had criticisms of each other's inputs and results, and in particular Mr. D'Ascendis's inputs and results, is with regard to Wall-Street analysts projected EPS growth rates for electric utilities.

Dr. Woolridge's testimony firmly establishes that Wall-Street analysts' projected EPS growth rates for electric utilities are overly-optimistic and upwardly-biased. Further, Dr. Woolridge's finding is supported by a study by Szakmary, Conover, and Lancaster (2008) who evaluated the accuracy of *Value Line's* three-to-five-year forecasts in EPS growth rates. Evaluating companies in the Dow Jones Industrial Average over a thirty-year time period, the study by Szakmary, Conover, and Lancaster found *forecasted* EPS growth rates to be significantly

¹⁵ CARD Exh. 4 – Woolridge Dir. at 2.

higher than the EPS growth rates that these companies subsequently achieved.¹⁶ They concluded that the EPS growth rate projection from *Value Line* are “incredibly overoptimistic.”

CARD also disagrees with the ALJs’ statement that “The economic metrics raised by the parties are not singularly aligned.” A clear example of the parties’ economic metrics aligning is interest rates. Dr. Woolridge’s testimony established that interest rates and capital costs are at historically low levels, utilities are raising capital in record amounts, and stock prices are at historic highs. No party provided credible evidence contesting Dr. Woolridge’s findings regarding interest rates and is a key example of an area where the parties’ economic metrics are aligned.

At bottom, capital is cheap, as indicated by the relevant economic metrics. Thus, while the ALJ’s do not identify the specific metrics to which they are referring,¹⁷ clearly a key relevant economic metric – interest rates – points to a lower ROE.¹⁸

The record evidence fully supports Dr. Woolridge’s recommended ROE. A return on equity of 9.00% is in the range of ROEs the ALJs identified as reasonable. A return on equity of 9.00% is also in the range of ROEs recommended by TIEC’s expert (8.90% to 9.35%) and only five basis points below the PUCT Staff’s range of ROEs (9.05% to 9.35%).¹⁹

CARD estimates the difference between the ALJs’ ROE of 9.45% and CARD’s recommended ROE of 9.00% is about \$4.7 million.²⁰ The difference is not insignificant when viewed in light of expected increases in customers’ bills attributed to extraordinary gas costs during Winter Storm Uri. As the Commission is aware, SWEPCO filed an application with the Commission seeking to recover about \$191.5 million in extraordinary fuel costs it incurred during

¹⁶ CARD Exh. 4 – Woolridge Dir. at 37.

¹⁷ Other than pointing to the DCF results and making general statements that “Some of the metrics argue in favor of a lower ROE, while others argue for a higher ROE” and that “appears to the ALJs that there is no clearly dispositive factor on the subjective side of the analysis,” the ALJs provide few other details as to how they concluded that a reasonable range for SWEPCO’s ROE is 55 basis points higher than the upper-end of the Staff’s range of ROEs.

¹⁸ See CARD Exh. 4 – Woolridge Dir. at 7-16 for Dr. Woolridge’s discussion of current and historical capital-market conditions supporting CARD’s conclusion that capital continues to be readily available and historically low costs.

¹⁹ See PFD at 103.

²⁰ See SWEPCO Exhibit 1 at Schedule A, page 2. At the Company’s ROR of 7.22%, the Net Op Inc on line 19 is \$175.3 million (total company). At the ALJs’ ROR of 6.79%, the Net OP Inc on line 19 is \$151.9 million (total company). At CARD’s ROR of 6.56%, the Net Op Inc on line 19 is \$139.5 million (total company). The difference between ALJ and CARD is \$151.9 million - \$139.5 million = \$12.4 million (total company). The Texas retail allocation factor for rate base is 37.58% from Schedule A-1 (line 11); so \$12.4 million x 37.58% = \$4.7 million.

Winter Storm Uri.²¹ While the cost of fuel is a pass-through expense for SWEPCO, it is not for the end-use customer; the proverbial buck stops with the customer.

CARD respectfully urges the Commission to adopt a ROE of 9.00%. A return on equity of 9.00% is well-supported by the record and the ALJs' PFD and presents a fair balance between stockholders' profits and reasonable rates for customers.

ii. Proxy Groups

iii. DCF Model Results

iv. CAPM Model

v. Critique of Mr. D'Ascendis' ROE Recommendations

a. Capital Market Conditions

b. D'Ascendis' DCF Analysis

c. Risk Premium Approach

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e. Use of Non-Price Regulated Companies

f. Adjustments for SWEPCO's Size and Credit-Ratings

2. Cost of Debt

B. Capital Structure [PO Issue 7]

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1. Transmission O&M Expense [PO Issue 24]

²¹ See *Application of Southwestern Electric Power Company to Implement a Net Interim Fuel Surcharge*, Docket No. 52397, Application at 1-10 (Aug. 6, 2021).

2. **Transmission expense and revenues under FERC-approved tariff [PO Issue 46]**
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- 2. Renewable Energy Credit Rider [PO Issues 47, 48]**

E. Retail Choice Pilot Project

VIII. Baselines for Cost-Recovery Factors [PO Issue 4, 5, 52, 63]

A. Interim Transmission Cost of Service

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- J. Experimental Economic Development Rider**
- K. Any exceptions requested to PUC rules [PO Issue 64]**
- L. Should PUC approve requests for waivers? [PO Issue 65]**
- M. Compliance with Dkt. 46449 [PO Issue 66]**

XI. Conclusion

Respectfully submitted,

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**ATTORNEYS FOR CITIES ADVOCATING
REASONABLE DEREGULATION**

CERTIFICATE OF SERVICE

I hereby certify that on this the 7th day of October, 2021 a true and correct copy of the *Cities Advocating Reasonable Deregulation's Exceptions to the Proposal for Decision* was served upon all parties via electronic mail in compliance with SOAH Orders Nos. 4 and 13, and with the Commission's Order Suspending Rules, issued in Project No. 50664.

By: /s/ Leslie Lindsey

Leslie Lindsey